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Supreme Court of the United States

OCTOBER TERM, 1949

M. E. TRAFF,
Petitioner,

VERSUS

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT, AND SUPPORTING BRIEF

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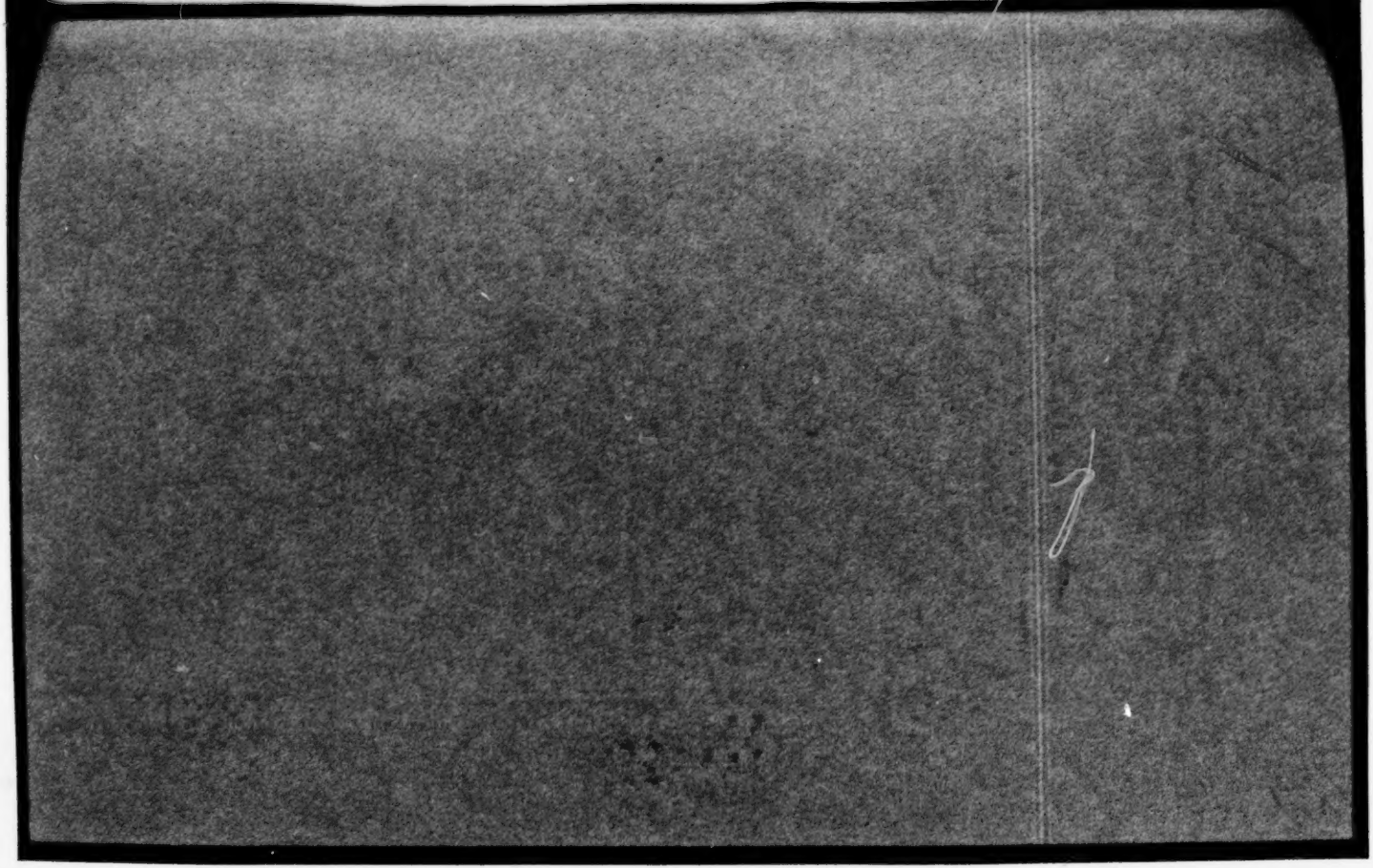
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January, 1950.

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No.———

Supreme Court of the United States

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VERSUS

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT, AND SUPPORTING BRIEF

PETITION FOR WRIT OF CERTIORARI

To the Honorable the Justices of the Supreme Court of the United States:

The above named petitioner respectfully shows:

I.

SUMMARY STATEMENT OF THE MATTER INVOLVED

This action was brought in the United States District Court for the Western District of Oklahoma, by the petitioner, against the United States, under the provisions of the Internal Revenue Code, for the recovery of income tax and interest thereon, alleged to have been erroneously col-

lected by H. C. Jones, as collector of internal revenue for the District of Oklahoma, who was out of office at the time the petition was filed (R. 4). The petitioner will be sometimes referred to herein as plaintiff or the taxpayer or by name.

The petition alleged that the collector of internal revenue had erroneously included the sum of $5,419.85 in the taxpayer's income, which was in fact the income of Lou Strang Trapp, his wife, because it was her share of income from property which they owned jointly and in community (R. 4). It was alleged that this property was the same as that involved in Case No. 93286 before the United States Board of Tax Appeals, in which the taxpayer was petitioner and the Commissioner of Internal Revenue was defendant (R. 4; 5-8), and in which said property was adjudged to be the joint or common property of the taxpayer and his wife (R. 4). A copy of the proceedings in the Board case was attached as Exhibit C to the Petition and made a part thereof (R. 4, 6-10, 271 through 275).

Estoppel by Judgment

From the exhibit and record, it appears that the amount of money in controversy in the Board case was $1,135.94, and that the issue was whether income derived during the year 1935, from oil and gas leases in the State of Texas, the legal title to which stood in petitioner's name, and which were managed and operated by him, was community income under the law of that state and one-half was returnable for taxation by the petitioner and one-half

by his wife (R. 6). The facts alleged in that regard were as follows:

> "(a) The petitioner is, and was at all times herein mentioned, married and residing with his wife, Mrs. Lou Strang Trapp, in Oklahoma City, in the State of Oklahoma. Prior to the year 1935, he acquired certain oil and gas leases in the State of Texas, the title to which was taken in his name. The consideration for these leases was in part personal services rendered by him in the State of Texas, in obtaining them, and in part cash paid from funds that were the common property of him and his wife. Before 1935 wells had been drilled on the leases and they were producing oil and gas. The petitioner had personally conducted, supervised and managed the business of developing them for oil and gas, after producing wells were drilled, and continued during the taxable year personally to oversee, manage, develop and operate them. The leases involved are designated by name as the King Lease, the Crisp Lease and the Bob White Lease. During the year 1935, the net income to the petitioner, as operating lessee of these leases, was $15,555.66. He says that under the laws of the State of Texas and the Income Tax Laws of the United States, this net income so derived from these leases was community income to himself and his wife, and one-half thereof was returnable by his wife, for taxation as her income. The respondent has denied that said income was community income and has ruled that all thereof was income of the petitioner and returnable by him for taxation, and has included it in his income, subject to tax, and determined the deficiency here involved accordingly. The petitioner says that this action of the respondent is erroneous" (R. 7).

A settlement of the case was agreed on by the parties

and a stipulation filed with the Board for entry of a judgment for $643.32 (R. 10). This sum was the amount of the deficiency not involved in the issue above stated (R. 7-8). The taxpayer filed an affidavit with the Board, which was the basis for the settlement agreement, as follows:

> "M. E. Trapp, being first duly sworn, on his oath says that he is the petitioner in the above entitled proceeding; that he and his wife, Mrs. Lou Strang Trapp, have been married for more than 24 years; that at the time of their marriage and since, she has had separate property and separate income and he likewise has had separate income; that shortly after their marriage and for more than twenty years last past they have combined and pooled their incomes in a common fund and have deposited all monies received by either of them in a common or joint bank account, upon which each had authority to and did check at will; that all money in this account was considered and deemed by them to be and was the common property of both; that in 1932 petitioner, with funds drawn from the common bank account of himself and wife and which was their common property, purchased an oil and gas lease in the State of Texas, known as the King lease, and in 1933, in the same manner and with funds of the same kind, purchased two other oil and gas leases in the State of Texas, known as the Crisp Lease and the Bob White Lease; that these leases were developed by the drilling of oil and gas wells thereon, with the common funds of petitioner and his wife, as above described, and production was realized prior to and during the year 1935, and the proceeds from the sale of such oil and gas production were considered and deemed to be by petitioner and his wife, and were, their common property and income, and in so far as the same were deposited in the bank, were deposited

in their said common or joint bank account, subject to check of either of them at will; and that the income derived from said leases was regarded and deemed to be by petitioner and his wife their common property in fact, as well as common or community income under the laws of the State of Texas" (R. 8-9).

In the petition in the instant case, an error by the Commissioner in computation of the tax was alleged (R. 5), and this was admitted upon the trial, and hence is not involved here.

On the trial, CHAS. H. GARNETT (who was not then employed as an attorney in the instant case) testified that he was attorney for the taxpayer in the Board case and that the income in controversy was derived from oil properties in Texas which had been acquired in part by purchase and in part by services rendered by the taxpayer in Texas (R. 66); that he negotiated the settlement of the case with the attorney for the Commissioner and that the issue was whether the income in controversy was joint or community income, or was separate income; that in determining this, two questions were involved; one as to the purchase of the property in Texas with joint funds, and the other as to the value of services rendered by the taxpayer in acquiring the property; and that the stipulation and settlement conceded both of those in favor of the taxpayer (R. 69). Judgment was entered by the Board for the deficiency stipulated by the parties (R. 10).

The Commissioner recognized and followed the decision of the Board in determining the tax liability of the taxpayer and his wife, for the years 1936 through 1939, and divided their incomes equally between them for income tax

purposes (R. 72). Both courts below held that because a judgment was entered for the defendant for a fixed sum, without a trial or any judicial action on stipulated facts, it did not constitute an estoppel by judgment for the defendant in the instant case in respect to income derived from the same properties (R. 25, 263). The trial court also held that there had been a change in the Federal Law with respect to family partnerships since the Board's decision in 1940 (R. 25).

The plaintiff sought to show that, without waiving reliance on his plea of estoppel, he and his wife, Lou Strang Trapp, had formed a partnership soon after their marriage and that all their property and income to and including the year 1940 was jointly owned by them in equal parts. He testified that, soon after their marriage and about the year 1911, he and his wife agreed to engage in the bond and investment business. He had no funds of his own and his wife contributed from her separate property which she had acquired by inheritance and from investments and her personal earnings in employment prior to her marriage, all the original capital of their partnership. This was approximately $15,000.00 in amount (R. 79; 200-201). The business was to be carried on in his name, but she actively assisted in it, and there was to be an equal division of all profits. Their bank account was first carried in her name and then in his name and then in both of their names (R. 22, 162-163). This partnership prospered and continued without interruption, except that it was inactive while he was Governor of Oklahoma, down through the year 1940. The banks with which he did business were informed of the fact that his wife was half owner of the bonds and

properties and bank account standing in his name. Prior to 1935 all income tax returns were made in his name alone, and were in effect joint returns for him and his wife. His salary as Governor was exempt from taxation and most of their income was interest on municipal bonds which was also exempt, and their tax liability for those years was only nominal in amount (R. 78-83).

F. G. BABB, testified that in 1922 he was an officer of the Security National Bank in Oklahoma City, and Mr. Trapp applied to the bank for a line of credit for purchasing municipal bonds. He stated to the bank officers that he started on his wife's money and that everything he had belonged to her as much as to him, but that he did business in his own name. He proposed to deposit municipal bonds as security for credit extended to him, and the bank took his bonds on the basis of his statement and with knowledge that Mrs. Trapp had an interest in them. She signed a guaranty of the account with the bank, and stated that she was just as much obligated as Mr. Trapp was (R. 148-150). She sometimes came to the bank and gave directions in respect to the account (R. 151).

Neither Mr. nor Mrs. Trapp ever made any withdrawal of funds from their joint business for use or investment in a separate business or property. The only personal withdrawals by either one from their joint bank account were for living expenses and personal or incidental purposes (R. 82, 22). The trial court held that, even though there had been a family partnership between petitioner and his wife, under Oklahoma law, it could not be recognized under Federal law for income tax purposes (R. 21-23) and this was affirmed by the appeals court (R. 261-262).

The trial court also held that there had been a change in the Federal law in respect of family partnerships since the Board decision in 1940 (R. 25).

Presumptive Correctness of the Commissioner's Ruling

The trial court held that the Commissioner's ruling that the Trapps were not partners, was presumptively correct, and that the plaintiff had the "burden of overcoming such presumption by persuasive evidence" (R. 23), and that whether the partnership existed was not to be determined by Oklahoma law, but for income tax purposes was to be determined by Federal law (R. 23). This holding was affirmed by the appeals court (R. 261-262). That court concedes that the presumption of correctness attached to the action of the Commissioner disappears when evidence sufficient to sustain a contrary finding has been introduced, but it enumerates evidence of material findings by the trial court, which it deems sufficient to support the finding that there was no partnership independently of the presumption of correctness of the Commissioner's ruling (R. 261), but the trial court made those findings by weighing the taxpayer's evidence against the presumption, and held that such evidence was "not sufficiently strong to overcome the Commissioner's finding" (R. 21-22-23). Of these, the findings that she never took any active part in their businesses (R. 82) and that neither of them ever held out any of their business ventures as partnership transactions (R. 158-160) and that she did not contribute any substantial portion of her separate estate to the joint enterprise (R. 78; 200-201) are contrary to the undisputed evidence ap-

pearing at the above citations to the Record. None of the other particular findings enumerated tend to negative the existence of the partnership.

The Employment of the Skill, Labor and Supervision of the Taxpayer in the Operation of the Texas Leases.

All the oil and gas leases in Texas were developed and operated by the taxpayer and his skill, labor and supervision were employed in such development and operation (R. 182). The trial court held that nevertheless all the gain from the operation of those leases, attributable to the separate property interest of the taxpayer therein, was his separate income (R. 17, 18). The appeals court affirmed this holding (R. 265). This is contrary to Texas law.

Addition of the Cost of Improvements to Taxpayer's Separate Interest.

The trial court held as a matter of law that the cash payment made in the acquisition of the King, Crisp and White leases and also the value of the taxpayer's services in acquiring them (R. 25-28) constituted the original acquisition cost, and held that the interest in them attributable to the cash payment was the separate property of the taxpayer, and the interest attributable to the value of his services was community (R. 26-28; 41). Then the court determined the amount of money spent in improving those leases, by drilling and completing oil wells thereon, termed capitalized drilling costs, regarding this as paid out of the taxpayer's separate money, and added this amount to the original cash payment and increased the separate interest or estate of the taxpayer in the leases proportionately

(R. 41-44). The court computed the separate interest and the community interest in the leases on percentages and based the taxpayer's percentage on the original cash payment, plus all the cost of the improvements, and the community percentage on the value of his services in acquiring the leases (R. 41). For example, the application of this method is shown in the King lease as follows:

Leasehold costs	$ 6,822.35		
Capitalized drilling	63,721.92		
Total property costs		70,544.27	85.75%
Value M. E. Trapp services		11,720.00	14.25%
Total property costs plus services (R. 41).		82,264.27	100.00%

Then to the 85.75 per cent of leasehold cost and capitalized drilling, the court added one-half of the 14.25 per cent community interest attributable to Mr. Trapp's services and fixed 92.875 per cent of the income as taxable to him and 7.125 per cent as taxable to Mrs. Trapp (R. 41). This holding was affirmed by the appeals court, but by erroneously stating what the trial court did in the following language:

> "The court ascertained the amount of cash paid for the leases, ascertained the reasonable value of the labor, talent, and skill contributed by the taxpayer, and classified the income derived in 1940 as separate and community income in the same proportions. The portion of the income attributable to the purchase price paid in cash was treated as separate income, and the portion attributable to the value of the services of the taxpayer was treated as community income, taxable as such" (R. 265).

Thus it appears that the appeals court ignored the action of the trial court in adding the cost of the improvements to the "cash paid for the leases" and basing the percentage of the taxpayer's separate estate in the leases on that total.

The petitioner says that, under the law of Texas, the separate and community interests in the leases were fixed at the time of acquisition and neither could thereafter be increased or diminished by the cost of improvements thereon.

Commingling of Funds

The undisputed evidence is that all the income from the Texas leases, part of which was admittedly community, was from first production in 1932 through the years to 1940, deposited in the bank account of the parties, in the Liberty National Bank of Oklahoma City, a part of which account the court held was the separate property of the taxpayer (R. 215). Money borrowed by the taxpayer, held to be his separate funds, also went into this account. After the separate and community funds were thus commingled in that account, it was impossible to identify a particular number of dollars as community and a particular number as separate. Checks were freely drawn on this account, for expenses and for all purposes in connection with the operation of the leases and for any other purpose desired by the parties.

Out of this commingled account, checks were issued in payment of interests purchased in the Moseley, Milas and

Fenn leases (R. 233). The trial court held that these checks were payments made by the taxpayer out of his separate funds, and that the interest so acquired in the leases were his separate property (R. 28).

The appeals court affirmed this holding, but erroneously stated that the taxpayer borrowed the money with which his interests in those leases were purchased (R. 28; 233; 265), and ignored the fact that community funds were deposited in the bank account for all the years from 1932 through 1940 (R. 215). That court seemed to be under the impression that the commingled bank account was involved for the year 1940 only, and said:

> "The gain derived from these leases during the taxable year in question has not become so confused and commingled that it is impossible to trace and identify it with reasonable certainty" (R. 266).

The taxpayer never made any point that separate and community incomes for the year 1940 were commingled in one bank account. His point was and is that for at least nine years prior to 1940 such incomes were commingled and that the trial court entirely disregarded the deposit of community income in that account and treated all funds withdrawn from it for any purpose as the separate funds of the taxpayer, including the money spent for improvements on the oil and gas leases (R. 217; 41).

II.

DECISIONS BELOW

The trial court's decision is reported in 73 Fed. Supp. 385 and in 79 Fed. Supp. 320. Its findings of fact and conclusions of law and judgment appear in the Record at pages 20 to 44. The decision of the Court of Appeals, Tenth Circuit, was filed September 14, 1949 (R. 259), and is reported in 177 Fed. (2d) 1. Petition for rehearing was denied November 2, 1949 (R. 280).

III.

JURISDICTION

The jurisdiction of the Court is invoked under Sec. 240 (2) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938, 28 USCA, Sec. 347 (2), and/or Chapter 133, Sec. 2101 (c), Title 28, United States Code, Judiciary and Judicial Procedure, approved June 25, 1948, effective September 1, 1948.

IV.

QUESTIONS PRESENTED

The following questions are presented:

1. Whether the determination of the issue of the joint or community ownership of property by the taxpayer and his wife in an action before the Board of Tax Appeals by the taxpayer, against the Commissioner, involving the year 1935, by a judgment in favor of the taxpayer, entered upon a stipulation of the parties and accepted and followed by the Commissioner for the years 1936 to 1939 inclusive,

constitutes estoppel by judgment of the defendant in the instant case involving the year 1940 in respect of the ownership of the same property.

2. Whether the evidence in this case was sufficient as a matter of law to establish the claim that the taxpayer and his wife had in good faith formed a commercial partnership about the year 1911, which was valid under Oklahoma law and was continued without interruption throughout the year 1940, and met the requirements of the decisions of the Federal courts, in respect to the recognition of family partnerships for income tax purposes.

3. Whether the presumptive correctness of the Commissioner's determination of a deficiency in tax, which determination was admittedly erroneous in part, where evidence sufficient to establish a contrary finding had been introduced, could be weighed and considered as evidence sufficient to overcome the evidence of the taxpayer to the contrary.

4. Whether, under the community laws of Texas, the gain or loss from the operation of an oil and gas lease, which is separate property but which employed the skill, labor and supervision of one or both of the spouses, constituted a community gain or loss.

5. Whether under Texas law and decisions, the status of property as separate or community, is fixed by the facts of acquisition at the time thereof, or changes from year to year, as held by the trial court, by reason of improvements placed thereon through funds from the community or separate estate of either spouse.

6. Whether under Texas law, where community funds and separate funds are commingled in a common bank account, so that the identity of each class of funds is lost, the whole of the funds thus commingled becomes community funds or separate funds.

7. Whether under Texas law and decisions, property purchased by the husband, with another as tenant in common, and operated in partnership, or purchased by the husband in partnership with another, where the interest purchased by the husband was with joint or community funds of husband and wife, and the income was produced by the use of the labor, services and supervision of the husband, the income distributed to the husband is separate or community.

V.

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT

The following reasons are relied on for allowance of the Writ:

FIRST: That both courts below have rendered decisions in conflict with other Circuit Courts of Appeals on the same matters, and have decided Federal questions in conflict with applicable decisions of this Court, in the following particulars:

(a) The holding that the issue of the joint or community ownership of property by the taxpayer and his wife, in an action before the Board of Tax Appeals, by the taxpayer against the Commissioner, involving the

year 1935 and decided in favor of the taxpayer by a judgment entered upon a stipulation of the parties did not constitute estoppel by judgment of the defendant in the instant case in respect to the ownership of the same property, is in conflict with the decisions of other Circuit Courts of Appeals on the same matter and with applicable decisions of this Court.

(b) The holding that the evidence was not sufficient in law to support the claim that the taxpayer and his wife had formed a legally valid partnership, on or about the year 1911, to engage in the bond and investment business, and that such partnership had continued without interruption to and throughout the year 1940 here involved and that the existence of such partnership was not to be determined by Oklahoma law, but by Federal law, is in conflict with the decisions of other Circuit Courts of Appeals, on the same matter and with applicable decisions of this Court.

(c) The judgment of the trial court, based on the presumption of correctness of the Commissioner's determination, after such determination was proved and held erroneous, and after evidence sufficient to sustain a contrary finding had been introduced, is in conflict with decisions of other Circuit Courts of Appeals on the same matter.

SECOND: That both courts below decided important questions of local law in a way in conflict with applicable local decisions in the following particulars:

(a) The holding that the gain from the operation of oil and gas leases in Texas, whether separate or com-

munity property, but the operation of which employed his skill, labor and supervision, was not community gain in its entirely, but was separate gain to him in proportion to his interest therein, is in conflict with the applicable decisions of the appellate courts in Texas.

(b) The holding that the status of oil and gas leases under Texas law, is not fixed by the facts of acquisition at the time thereof, but changes from year to year, by reason of improvements placed thereon, through funds from the community or separate estate of either spouse, is in conflict with the applicable decisions of the appellate courts of Texas.

(c) The holding that where community funds and separate funds originating in the State of Texas were commingled in a common bank account, so that the identity of each class of funds was lost, funds subsequently withdrawn from that account were separate funds, is in conflict with the applicable decisions of the appellate courts of Texas.

WHEREFORE, your petitioner prays that a Writ of Certiorari issued under the seal of this Court, directed to the United States Court of Appeals, Tenth Circuit, at Denver, Colorado, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings which said Court had in Case No. 3851, entitled M. E. Trapp, Appellant, v. United States of America, Appellee, to the end that such cause may be reviewed and determined by this Court, as provided by its rules and the statutes of the United States, and that the judgment of said United States Court of Appeals in said

cause be reversed by this Court, and for such further relief as to this Court may seem proper.

Dated at Oklahoma City, Oklahoma, this 24th day of January, 1950.

RAM MORRISON,
Petroleum Building,
Oklahoma City, Oklahoma,

JOHN B. DUDLEY,
Apco Tower,
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Attorneys for Petitioner.

BRIEF IN SUPPORT OF PETITION

DECISIONS BELOW

The trial court's decision is reported in 73 Fed. Supp. 385 and in 79 Fed. Supp. 320. Its Finding of Fact and Conclusions of Law and Judgment appear in the record, at pages 20 to 44. The decision of the Court of Appeals, Tenth Circuit, was filed September 14, 1949 (R. 259), and is reported in 177 Fed. (2d) 1. Petition for Rehearing was denied November 2, 1949 (R. 280).

JURISDICTION

The jurisdiction of this Court is invoked under Section 240 (2) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938, 28 USCA, Sec. 347 (2), and/or Chapter 133, Section 2101 (c), Title 28, United States Code, Judiciary and Judicial Procedure, approved June 25, 1948, effective September 1, 1948.

STATEMENT OF THE CASE

The petitioner and his wife, in 1912, entered into a partnership agreement to go into the municipal bond business together. Mrs. Trapp furnished all of the capital or credit to start the business. They were to share equally in the profits (R. 79, 162). The business was successful and the profits were retained in the business and invested in a portfolio of municipal bonds (R. 79, 175). The bonds were used at the bank to establish credit (R. 148, 149). In 1930 they agreed to expand their business into the oil business (R. 123, 124). Their bonds were used to borrow money

to buy and develop the oil and gas leases in Texas (R. 154). The income from the leases was deposited in their joint bank account. The business was carried in the name of M. E. Trapp. The bank where they obtained credit, and those persons who had any interest in knowing, knew of their business relation. The first leases, King, Crisp and White, were purchased and the first wells were drilled on monies borrowed on their municipal bonds (R. 80, 148-153). The borrowed funds and further development of the leases were paid for out of the income from the leases. The Moseley, Milas and Fenn leases were purchased out of their joint bank account, in which the oil runs from the King, Crisp and White leases were deposited and constituted the principal source of the purchase and development money (R. 176-184). All of the leases, King, Crisp, White, Moseley, Milas and Fenn, located in Texas, were acquired, developed, managed and operated since acquisition, including the tax year in question, by the use of the personal labor, skill and supervision of M. E. Trapp (R. 182, 124).

SPECIFICATIONS OF ERROR

The United States Court of Appeals is in error on the following, to-wit:

(1) In denying the plea of equitable estoppel.

(2) In affirming the trial court's finding that no partnership existed, which was contrary to the evidence and contrary to the law.

(3) In affirming the trial court's judgment based on a presumption that did not exist.

(4) In holding that the taxable gain from oil and gas leases in Texas, in the production of which the labor, skill and supervision of the husband were employed, was separate income of the husband.

(5) In holding that the status of real estate, under Texas law, is not fixed by the facts of acquisition at the time thereof, but changes from year to year, by reason of improvements placed thereon, whether through funds from the community or separate funds of either spouse.

(6) In holding as a matter of law that the status of taxable gain from the King, Crisp and White leases in 1940 is determined by taking the cost of improvements thereon in other years (1932 through 1939) paid out of the taxpayer's separate funds, together with his contribution to taxable gain in 1940, and classifying the gain in 1940 as community or separate in the proportion that the total value of the community or separate contributions bear to the total value of all contributions throughout the life of the leases.

(7) In holding, under Texas Community Law, that community property or funds commingled with separate property or funds so as to lose their identity, becomes separate property and not community.

(8) In holding that under Texas Community Law property purchased by the husband with another as tenants in common and operated in partnership, or purchased in partnership with another, where the interest purchased by the husband was with joint or community funds of husband and wife, and where the income therefrom was

produced by the use of the labor, services and supervision of the husband, the income distributed to the husband was his separate income and not community.

ARGUMENT

Summary of Argument

Point I.

In the Board of Tax Appeals case pleaded as estoppel, the only issue presented was the ownership of the King, Crisp and White leases and the income therefrom (R. 26-27). In the Pre-Trial Conference herein, the judgment roll in the prior action was admitted and it was there agreed that the only issue presented on the plea of estoppel was whether the stipulated judgment in the prior action settled this issue as between these parties. The Government took the position that it was a mere settlement between the parties, and nothing more, and that the issue was open for determination here (R. 273). The consent or agreed judgment before the Board (R. 6, 7-9) was entered under the practice encouraged by the Board, and in accordance with its rules (R. 8). The order settled the only issue between the litigants (R. 69, 24). The stipulation was based on the Commissioner conceding that the acquisition money for the leases was the joint money of the petitioner and his wife; that the value of personal services in acquisition was a community contribution under the case of *Hammonds* v. *Commissioner* (C. C. A. 10), 106 Fed. 240; that the leases, under Texas law, were community property and the income was distributable equally between the taxpayer and his wife on their tax returns (R. 69, 24). For

five years the Commissioner treated the consent judgment as settling the issue (R. 73, 75).

Under this Court's decision, it was error to deny the plea of estoppel.

Point II.

The trial court says that as a matter of law, it is not bound by Oklahoma law of partnerships, but by the interpretation of Federal tax law and Federal decisions (R. 23) and also states that, since the judgment on the 1935 income taxes, which was entered in 1940, the Federal law of family partnerships has been altered to such an extent that the judgment in that case no longer had effect as an estoppel. The court relied on *Commissioner* v. *Sunnen,* 331 U. S. 591, and *Commissioner* v. *Tower,* 327 U. S. 280 (R. 25). Its position was that although Mr. and Mrs. Trapp might have been partners in 1935, they are not now partners, by reason of the changed law. Petitioner contends the court is wrong under the decision in *Commissioner* v. *Culbertson,* 337 U. S. 733.

Point III.

The Commissioner's determination, that all the income from the leases was Mr. Trapp's, was held erroneous by the trial court. There was positive evidence, uncontradicted, by the petitioner, that he and Mrs. Trapp owned the properties jointly; that the acquisition money was joint money. For the trial court to hold that the evidence was insufficient to overcome the presumption of correctness of the Commissioner's determination, was error. The court

erroneously weighed the taxpayer's evidence against a presumption which no longer existed. The trial court's finding on the evidence is erroneous under this Court's decisions.

Point IV.

The trial court failed to apply the Texas Community Law and decisions in determining the ownership of the gain from the oil and gas leases. Under the Texas community law, the fruit from the industry or labor of either spouse is *fructus industriales,* as distinguished from *fructus naturales,* and is community. When the gain is derived from separate and community contributions, so indistinguishably mixed and especially where the toil and personal services of the spouse is used to create the gain, the gain is *fructus industriales* and is community under Texas law. All the gain from the leases is therefore community under Texas law.

Point V.

The trial court found, as a matter of law, that the acquisition facts determine the status of ownership of each lease. That the status of the income from the lease was determined by the ownership of the lease alone. The Court then proceeded to determine the ownership of each lease, by taking all the acquisition cost, development and improvement costs, and classified them as separate or community contributions. It held that the acquisition costs were separate, the acquisition services were community, that the development and improvement costs, although paid

for out of the income from the lease itself, was Trapp's separate contribution. Then it determined the status of ownership of the leases, by taking the total of the separate or community contributions and obtained its proportion to all contributions throughout the life of the lease. The status of the income was determined by the status of the ownership. It determined that the King lease was owned 92.875 per cent by Mr. Trapp and 7.125 per cent by Mrs. Trapp; that the income was owned in like proportion. Under this method, the ownership of the lease changes from year to year, since improvement costs affect the status of the lease ownership. This is erroneous under Texas law. Mrs. Trapp, through the contribution of Mr. Trapp's personal services, owned a community interest in the leases at the date of acquisition. The court so held. The lease was developed out of the income from the leases. The income when produced was in part community, but when plowed back into the property, the court held it was Mr. Trapp's separate money. Mrs. Trapp's community money was thus used to reduce her interest from year to year. In 1940 she only owned 7.125 per cent. The holding of the court is erroneous.

Point VI.

The court found that the income from the King, Crisp and White leases was part community. Yet, when the income from the leases was deposited in Mr. and Mrs. Trapp's joint bank account, and there indistinguishably commingled, the funds became the separate funds of Mr. Trapp. When these funds were used to improve and develop the lease, they decreased Mrs. Trapp's community interest.

Therefore, Mrs. Trapp's interest has decreased from year to year. The court also held that in 1934, when the Moseley and Milas leases were purchased out of the funds in the joint bank account (the principal source of which were from the oil income from the King, Crisp and White leases), that all the funds were Mr. Trapp's separate funds. Under Texas community law, commingled funds would be community.

Point VII.

The trial court held that the Moseley, Milas and Fenn leases, which were purchased in 1934 and 1937, and which were owned as tenant in common with one Blankenship, and operated together, or owned in partnership with Blankenship, were Trapp's separate property and the income his separate income. The court held the income was separate because the legal title was held in partnership with another, and Mrs. Trapp was not a member of that partnership. The personal services of Mr. Trapp, in acquiring the leases and in developing and operating them, did not make a part of the ownership of the leases or the ownership of income, community. Not only did the court deny Mrs. Trapp her right in the income from the King, Crisp and White leases that went into the acquisition cost of these leases, but also denied to her the community right in the *fructus industriales*, which was created through the personal labor and services of her husband. This holding is also contrary to the Texas community law.

ARGUMENT

Proposition I.

The court below is in error in holding that a judgment by consent or agreement fails to constitute an effective judicial determination of any litigated right, which will support a plea of estoppel.

General Statement

In the Pre-Trial Conference, it was agreed that the only issue on the plea of equitable estoppel was the effect of the judgment entered on the stipulation of the litigants in the prior action (R. 272-274). This issue was presented in briefs (R. 275). Because of an expression of the trial court, evidence was presented at the trial, to show how the settlement was arrived at (R. 66-69). This evidence supported the "AFFIDAVIT OF M. E. TRAPP IN SUPPORT OF PROPOSED STIPULATION OF SETTLEMENT", which was filed before the Board (R. 8 and 9). The findings of fact of the trial court are consistent with the contention and evidence of the petitioner (R. 23 through 24). The conclusions of law of the trial court followed the Government's contention that a consent judgment did not settle or adjudicate the issue here (R. 25).

This holding of the trial court is contrary to the decisions of this Court, in the following cases: *Burgess* v. *Seligman*, 107 U. S. 20; *U. S.* v. *Parker*, 120 U. S. 89; *National C. & St. L. R. Co.* v. *U. S.*, 113 U. S. 261; *Harding* v. *Harding*, 198 U. S. 317.

This holding is contrary to the decisions of other

Circuit Courts: *O'Cedar Corp.* v. *F. W. Woolworth Co.* (C. C. A. 7), 66 Fed. (2d) 363; *Snell* v. *J. C. Turner Lumber Co.* (C. C. A. 2), 285 Fed. 356; *Rector* v. *Suncrest Lumber Co.* (C. C. A. 4), 52 Fed. (2d) 946; *Warner* v. *Tennessee Products Co.* (C. C. A. 6), 57 Fed. (2d) 642; *Pick Manufacturing Co.* v. *General Motors Co.* (C. C. A. 7), 80 Fed. (2d) 639; *Ventura Consolidated Oil Fields* v. *Rogan* (C. C. A. 9), 86 Fed. (2d) 149; *Bullard* v. *Commissioner* (C. C. A. 7), 90 Fed. (2d) 144; *Reconstruction Finance Co.* v. *Central Republic Trust Co.* (C. C. A. 7), 128 Fed. (2d) 242; *Woods Brothers Construction Co.* v. *Yankton County* (C. C. A. 8), 54 Fed. (2d) 304.

It is contrary to the decisions of the Tenth Circuit in these cases: *Hot Springs Coal Company* v. *Miller* (10 C. C.), 107 Fed. (2d) 677; *Eberle* v. *Sinclair Prairie Oil Company* (10 C. C.), 120 Fed. (2d) 746; *Continental Petr. Co.* v. *U. S.*, 89 Fed. (2d) 91.

It is contrary to Oklahoma decisions and general law: *Grayson* v. *Pure Oil Co.*, 189 Okla. 550, 118 Pac. (2d) 644; *Cobb* v. *Killingsworth*, 77 Okla. 186, 187 Pac. (2d) 477; 31 Am. Jur., Sec. 464, p. 107; 34 C. J., Sec. 332, page 130; 2 A. L. R. (2d), page 516; *Libbie Rice Farish*, 2 T. C. 949; Restatement of Law of Judgment, Sec. 368, top of page 304.

Even if no answer was filed, as held by the Circuit Court (which is in conflict with the stipulation in the Pre-Trial Conference), a judgment by consent operates as a waiver of all defects or irregularities in the process, pleadings or other proceedings previous to the rendition of the judgment, except such as involve the jurisdiction of the Court: *Simons, Trustee,* v. *Bayard*, 30 Fed. 532; *Woods*

Brothers Construction Co. v. *Yankton County, supra; Burgess* v. *Seligman, supra; Nashville C. & S. T. L. R. Co.* v. *U. S., supra; Swift and Co.* v. *U. S.*, 276 U. S. 311; 34 C. J., page 134, Sec. 338; 49 C. J. S., Sec. 178, page 314; *Fleming* v. *Warshawsky & Co.* (7 C. C.), 123 Fed. (2d) 623.

Equitable estoppel is as applicable to the Government in tax cases, as to any other litigant. *Tait* v. *Western Maryland R. R. Co.*, 289 U. S. 620.

The trial court's finding that a judgment entered on stipulation does not constitute a hearing, is contrary to the decision of the Court of Claims in *Bankers Reserve Life Insurance Co.* v. *U. S.*, 44 Fed. (2d) 1000.

The common law doctrine of retraxit applies to a consent judgment. Where a litigant admits in open court that there is no further weight to be given to his contention, and that judgment can be entered for an adversary, it will bar him from further litigation on the same subject matter between the parties. This is fundamental. It is the Oklahoma rule, the rule of this Court and the common law rule. 3 Blackstone Commentaries 296; *U. S.* v. *Parker, supra; Jacobs* v. *Marks*, 182 U. S. 583; *Bertleson* v. *White*, 58 Fed. (2d) 792.

The trial court erroneously denied the plea of estoppel by judgment, upon the theory that a stipulated judgment was not a judgment on the merits because the minds of the Board of Tax Appeals did not pass on the matter and therefore it was merely a settlement between the parties. The entry of the judgment was a function of the court and an exercise of judicial power. To say that the court's mind

did not pass on anything, is error. *Bridigo Urbino et al.* v. *Porto Rico Ry. L. & P. Co.*, 68 Fed. Supp. 841. (Citing the decisions of this Court listed above.)

The Court in *Burlen* v. *Shanon*, 99 Mass. 200, 96 Am. Dec. 733, said in substance, there is language or expression in some of the cases which indicates otherwise, but upon examination, the language is just an "imperfectly guarded expression" and, although susceptible to a different construction without analysis, when closely analyzed does not support the rule announced by both the lower courts in the instant case. They cited *Fruehauf Trailer Co.* v. *Gilmore* (10 C. C.), 167 Fed. 324. In that case, the judgment in the prior action, which was pleaded as an estoppel, was based on a different cause of action, between different parties, and a different ground of relief and therefore equitable estoppel would not apply under the general rule itself. We examined every case cited in the *Fruehauf* case and none of them will support the principle announced by the lower courts in the instant case. The case of *Blaffer* v. *Commissioner*, 134 Fed. (2d) 389, cited by the lower courts, does not support the principle. There were two issues—one was a new issue which was not pleaded or determined in the prior action, and the second issue was a similar one, raised on a new set of facts, new circumstances, from those involved in the prior action. On neither issue would the doctrine of equitable estoppel apply under the general rule itself. The courts below also cited *Hartford-Empire Co.* v. *Commissioner*, 137 Fed. (2d) 540. This case was not decided on the principle announced herein by the lower courts. There, the issue before the Court was a new issue

not raised or adjudicated in the prior action pleaded as an estoppel.

Riter v. *Commissioner*, 3 T. C. 301, was also cited by the lower courts. This case is distinguishable on the facts. In the *Riter* case, the Court held that it could not tell from the record what issue was determined in the prior action. Upon that holding the doctrine of equitable estoppel would not apply under the general rule. So the taxpayer there failed on the evidence. The principle announced in the syllabus of the case was taken from *dictum* in other cases. The principle announced in the syllabus was not the basis of the decision in any case cited to support it. There is no authority to support the rule announced.

As stated by the editorial writer, in discussing and analyzing all the cases up to date, in 2 A. L. R. (2d) at page 540:

> "Notwithstanding certain unqualified statements therein, none of the cases referred to in Section 9 *supra* actually supports the rule that the mere fact that a judgment was entered by agreement or consent, prevents its operation as *res judicata*."

and at page 544:

> "Except in cases involving tax liability for successive tax periods, it is well settled that a judgment by consent raises an estoppel in the same way as a judgment entered after contest, and this has been recognized even by those courts which profess to adhere to the theory that a consent judgment or decree is, strictly speaking, not *res judicata*."

The cases quoted in the exception are, *Riter* v. *Com-*

missioner, supra, and the decision of the trial court in this case. So the contention of the Commissioner that the principle of estoppel by judgment does not apply in income tax cases has been established as an exception to the rule if the instant case is permitted to stand. This exception is in direct conflict with the judgment of this Court in *Tait* v. *Western Maryland RR. Co., supra.* The amount involved in this appeal is merely incidental—the cost of the appeal exceeds the amount involved, but the principle involved, the security and sanctity of the judgments of this Court and the final judgments of courts of record are at stake. Litigants and citizens are entitled to know upon what they can rely. Is it the judgment of this Court and the other courts of record, or is it to be the contention of some agency of the Government, to be held inviolate and thus upsetting the established rights and the security of citizens?

Proposition II.

The judgment is based on wrong legal criteria, in determining the existence of a family partnership, under the decisions of this Court.

General Statement

The Commissioner determined that the capital contribution of Mrs. Trapp, to the family partnership, was negligible and under *Commissioner* v. *Tower,* 327 U. S. 280, 286, the trial court held the contribution was insufficient to support a determination that there was a partnership. (See evidence McMullin, page 190; Dyche, page 187, and Carleton, page 184.) It was the contention of the

Government that a substantial contribution of capital or services determined the issue. The trial court held that the petitioner relied on joint contribution alone, to prove that the property was jointly owned. The trial court followed the Commissioner's determination that Mrs. Trapp's contribution, under the *Tower* opinion, was insufficient, in this language:

> "The plaintiff's evidence fails and the preponderance of evidence fails to establish that Mrs. Trapp contributed any consequential portion of such estate, to the taxpayer for his individual use or for conducting a joint enterprise in behalf of the taxpayer and his wife. She remains silent as to such contribution" (R. 21-22).

The conclusion of law was:

> "The Commissioner's ruling that the Trapps were not partners presumptively is correct, and the plaintiff has the burden of overcoming such presumption by persuasive evidence. *Commissioner* v. *Tower*, 327 U. S. 280, 286; *Wickwire* v. *Reinecke* 275 U. S. 101; *Welch* v. *Helvering*, 290 U. S. 111, 115. Whether a partnership existed is not a matter of Oklahoma law, but is governed by the interpretation of federal tax law and the federal cases. *Commissioner* v. *Tower, supra; Lusthaus* v. *Commissioner*, 327 U. S. 293. The plaintiff, having failed to establish a genuine partnership within the meaning of 26 U. S. C. A., Sections 181 and 182, may not escape upon this issue any tax on income earned by him and due under 26 U. S. C. A., Sec. 22(a)" (R. 23).

The trial court in its conclusions of law announced the existence of a new partnership law:

> "The growth of the principles controlling the effect of partnership relations between members of a family

and distribution of income for Federal tax purposes in such cases has altered to such an extent since the settlement of the 1935 income tax and the entry of the *pro forma* judgment thereon, that such settlement or said judgment has no longer any effect under the application of the principle of collateral estoppel by judgment" (R. "C" 25).

By that interpretation of *Commissioner* v. *Tower, supra,* the Court has declared that there is a new family partnership law.

The trial court determined that the taxpayer's positive evidence did not overcome the presumption of correctness of the Commissioner's determination, which was that no substantial contribution of capital, satisfactory to the Commissioner, was shown, therefore no partnership existed, under Federal law.

The trial court did say that certain facts taken together, which included the adverse determination against the taxpayer, on the contribution toward the family partnership, strongly overcame *any assumption* of joint ownership of the properties, or of partnership (R. 22-23). The trial court did not say that from all the facts and circumstances Mr. and Mrs. Trapp did not agree in good faith to pool their capital and/or services and enter into the bond business to share the profits and losses together (R. 22, 23 and 24). What evidence was there that Mrs. Trapp made no substantial contribution? It was the uncontradicted evidence of the taxpayer that she contributed $15,000.00 which was all of the original money or capital, with the understanding that they would share equally in the profits

(R. 79). This evidence the trial court held was insufficient. Insufficient against what?—insufficient to overcome the presumption of correctness of the Commissioner's determination. The trial court could not arbitrarily disregard the positive undisputed testimony of the taxpayer. *Forgan* v. *Commissioner* (5 C. C.), 165 Fed. (2d) 705; *Ohio R. Co.* v. *Martin*, 283 U. S. 209; *San Francisco Association for the Blind* v. *Ind. Aid for Blind* (8 C. C.), 155 Fed. (2d) 532.

The trial court's judgment was founded on the contention of the Commissioner, which was based on the erroneous interpretation of various inferior Federal courts of this Court's decisions in the *Tower* and *Lusthaus* cases, which were fully discussed by this Court in its recent opinion in *Commissioner* v. *Culbertson, Sr.*, decided June 7, 1949, 337 U. S. 333.

In a decision rendered by the District Court for the Western District of Oklahoma, Honorable Edgar S. Vaught, Judge, in a suit by the same taxpayer involving the year 1941 on the same issue of the existence of a family partnership between the taxpayer and his wife, the court followed this Court's decision in *Commissioner* v. *Culbertson, Sr., supra*, and held that such partnership existed. Decided December 2, 1949, 87 Fed. Supp. 415, not yet officially reported.

The judgment of the trial court is based on erroneous legal criteria under this Court's decision, in *Commissioner* v. *Culbertson, Sr., supra.*

Proposition III.

The judgment is based on the presumption of correctness of the Commissioner's determination, after the determination was found and held erroneous, and is in conflict with the decisions of other Circuit Courts.

General Statement

The Commissioner determined that all of the income from the leases was the income of the taxpayer, M. E. Trapp (R. 100 through 106). The trial court held this was erroneous and gave judgment for the taxpayer (R. 31 through 44). There was positive uncontradicted evidence introduced to support each contention of the taxpayer. After the Commissioner's determination was found to be erroneous, and evidence sufficient to establish a *prima facie* case was introduced, it was error for the trial court to determine the issue by weighing the taxpayer's evidence against a presumption of correctness, when in law no presumption existed. The lower court's judgment is in conflict with the decisions of other Circuit Courts on this issue. *Russell* v. *Commissioner* (C. C. A. 1), 45 Fed. (2d) 100; *Hemphill School* v. *Commissioner of Internal Revenue* (9 C. C.), 137 Fed. (2d) 961; *Lawton* v. *Commissioner* (6 C. C.), 164 Fed. (2d) 380; *Crude Oil Corp. of America* v. *Commissioner*, 161 Fed. 809; Merten's Law of Federal Income Taxation, Vol. 9, Secs. 50, 71, page 297; *Clinton Cotton Mills, Inc.* v. *Commissioner* (C. C. A. 4), 78 Fed. (2d) 292; *Wichita Terminal Elevator Co.* v. *Commissioner* (10 C. C.), 162 Fed. (2d) 513.

Proposition IV.

The decision is in conflict with the statutes of Texas and applicable decisions of the Appellate Courts of Texas.

Under Texas law:

(a) The gain from oil and gas leases in Texas, in the operation of which leases the skill, labor and supervision of the husband is employed, is community gain regardless of whether the ownership of the leases is separate or community property.

(b) The status of property in Texas, as separate or community, is fixed by the facts of acquisition at the time thereof, and its character or ownership is not changed by reason of improvements placed thereon at any time thereafter through the use of funds from the community or separate estate of either spouse.

(c) Where separate and community funds are commingled in a common fund or bank account, so as to lose their identity, the entire fund or account becomes community property and where property is purchased with funds out of such commingled funds, such property is community.

(d) Where oil and gas leases are purchased by the husband, with another as tenant in common, and operated in partnership, or purchased in partnership with another, the interest purchased was paid for with joint or community funds of husband and wife, and the gain from the leases was produced by the use of the labor, services and supervision of the husband, the gain is a community gain.

General Statement

The law of the State in which real property is situated governs its acquisition, tenure and disposition and the classification of the income derived from it as separate or community, regardless of the marital situs or the residence of the owners. *Hammonds* v. *Commissioner,* 106 Fed. (2d) 420; *Noble* v. *Commissioner,* 138 Fed. (2d) 444. In the following respects, the judgment of the trial court, which was affirmed by the Court of Appeals herein, conflicts with the community property law of Texas, as established by the law and decisions of that State.

(a) The trial court held that the taxable gain from the oil and gas leases in Texas, that employed the skill, labor and supervision of the husband, Trapp, was his separate gain.

Under the exact evidence, from the same witnesses, the trial court found that the King, Crisp and White leases were operated, developed, and the gain produced, through the use of the personal services of Trapp, but makes no finding in this respect as to the Moseley, Milas, and Fenn leases (R. 124 and 182). The fact that the trial court made no finding concerning the personal services of Trapp, as to the Moseley, Milas and Fenn leases, and did not hold that all of the income from the King, Crisp and White leases was community, clearly shows that the trial court did not apply this rule of Texas community law in arriving at its judgment (R. 28). The question here resolves itself down to one of law. If the gain from the oil and gas leases in Texas is produced through the use of the skill, labor and supervision of the husband, and the gain is community

under Texas law, then the trial court's judgment is erroneous.

Under the statutes, and decisions of the courts of Texas, the gain from these leases is a community gain. Vernon's Civil Statutes of Texas Anno. (1925), Articles 4613 through 4627; Community Property, Art. 4622-4623; Sec. 91, 94 through 99, Vol. 23 Tex. Jur. (1932); G. C. M. 13742, Cumulative Bulletin XIII-2 for July-December, 1934 at pages 181 to 183; *Frame* v. *Frame*, 120 Tex. 61, 36 S. W. (2d) 152, 73 A. L. R. 1512; *Logan* v. *Logan* (Tex. Civ. App.), 112 S. W. (2d) 515, 524; *Johnson* v. *Commissioner*, 1 T. C. 1041, 1055; *Commissioner* v. *Wilson* (C. C. A. 5), 76 Fed. (2d) 766; *Commissioner* v. *Skaggs* (C. C. A. 5), 122 Fed. (2d) 721; Speer's Law of Marital Rights in Texas, 1916 Edition, Sec. 310, page 389; 11 Am. Jur. 194; 31 C. J. 20; *White* v. *Lynch*, 26 Tex. 195; *Forbes* v. *Dunham*, 24 Tex. 611; *Deblane* v. *Lynch*, 23 Tex. 25; *Schepflin* v. *Small* (Civ. App.), 4 Tex. 493, 23 S. W. 432; *Hayden* v. *McMillian* (Civ. App.), 4 Tex. 479, 23 S. W. 430. The trial court's judgment is therefore erroneous.

(b) The trial court held that the status of property in Texas, as separate or community, is not fixed by the facts of acquisition at the time thereof, but changes from year to year, by reason of the improvements placed thereon, through the use of funds from the community or separate estate of either spouse.

The trial court determined the ownership of the King lease by fixing the cost thereof at acquisition at $6,822.35, and fixed the value of the taxpayer's services in acquiring, perfecting title, developing and operating the lease at

$11,720.00 (R. 41). This, under Texas law, fixed the ownership of the lease as separate and community in the proportion of $11,720.00 to $6,822.35. Then, the court erroneously added to the taxpayer's alleged separate interest in the lease all of the cost of improvements thereon consisting of the drilling of oil and gas wells, termed Capitalized Drilling Cost, in the sum of $63,721.92, and fixed his separate cost in the lease at $70,544.27 (R. 41). It followed this method in all the other leases which was erroneous and is in direct conflict with Texas community law and declared by its courts. *White* v. *Hebbard* (Civ. App.), 89 S. W. (2d) 482; *Myers* v. *Crenshaw* (Civ. App.), 116 S. W. (2d) 1125; *Hipp* v. *Fall* (Civ. App.), 213 S. W. (2d) 732; *Webb* v. *Van* (Civ. App.), 210 S. W. (2d) 877; *Boyd* v. *Orr* (Civ. App.), 170 S. W. (2d) 829; *Gleich* v. *Bongio,* 128 Tex. 606, 99 S. W. (2d) 881; Merten's Law of Federal Income Taxation, Vol. 3 at page 66; McKay's Law of Community Property, 2d Edition, Secs. 342, 347 and 1013; 11 Am. Jur., page 187, Sec. 20, page 199, Sec. 39. The court's judgment is therefore erroneous.

The circuit court is in error in stating that the trial court classified taxable gain thus:

> "The Court ascertained the amount of cash paid for the lease, ascertained the reasonable value of the labor, talent and skill contributed by the taxpayer, and classified the income derived in 1940 as separate and community income in the same proportion" (R. 265).

The manner in which the trial court arrived at the judgment below is fully set out at pages 25, 26, 27 and 28 of the Record. The trial court did not determine the status

of the income from contributions to it, but took the capital contributions to developments and operation of the leases and determined the ownership of the leases. Neither the status of the gain nor the status of the lease ownership was determined by the acquisition costs, as stated in the circuit court's statement. The status of lease ownership was determined by taking into consideration, not only the contribution toward its cost, but also the cost of the improvements thereon, and the development and operation of it up to and including the year 1940. The status of income was in the same proportions community under the trial court's opinion. No attempt was made to classify income in 1940 under the Texas community law. As outlined in G. C. M. No. 13742 by Assistant General Counsel, Robert H. Jackson, of the Bureau of Internal Revenue, Cumulative Bulletin XIII-2, July-December, 1934, at pages 181 to 183, and the Texas decisions *supra*, cited above. The rule announced by the trial court or the circuit court has no supporting authorities cited, either by counsel for the Government or by the court in its opinion. Under this method, taxable gain in each year would be determined upon new facts and therefore a new issue. All the authorities cited above are applicable here.

(c) The trial court held that, where the separate funds of either spouse is commingled with community funds, in a common bank account, so as to lose their identity, the entire fund becomes separate funds, and property purchased in Texas out of the commingled funds was separate property, not community.

In the judgment, the trial court treated the runs from

the King, Crisp, and White leases, from 1932 through 1939, which were deposited in Mr. and Mrs. Trapp's joint bank account and there commingled with other funds, as Trapp's separate money or funds. When said funds were reinvested in the development of the property, they were treated as Trapp's separate funds. When the funds were used in the acquisition of the Moseley, Milas and Fenn leases, they were treated as Trapp's separate funds. An investigation of the Schedules, Plaintiff's Exhibit 2 (R. 213 through 255), gives a complete analysis of their joint bank account, showing where the monies deposited came from and where they were expended, and how the funds were commingled. The trial court's finding, that all of the commingled funds in the common bank account were Trapp's separate funds is error. The undisputed evidence is that all the income from the Texas leases, part of which was admittedly community was, from the first production in 1932 through the years to 1940, deposited in the joint bank account of Mr. and Mrs. Trapp in the Liberty National Bank of Oklahoma City, Oklahoma (R. 215), a part of which account the court held was the separate property of the taxpayer. Money borrowed by the taxpayer, held to be his separate funds, also went into this account. After the separate and community funds were thus commingled in that account it was impossible to identify a particular number of dollars as community and a particular number as separate. Out of this commingled account checks were issued for interests purchased in the Moseley, Milas and Fenn leases (R. 233). The trial court held that these checks were payments made by the taxpayer out of his separate funds and that the interests so acquired were his separate properties (R. 28).

This is contrary to Texas law. *Finley* v. *Pafford* (Civ. App.), 104 S. W. (2d) 163; *Smith* v. *Buss*, 135 Tex. 566, 144 S. W. (2d) 529; *McJunkin* v. *Republic Natl. Bank of Dallas* (Civ. App.), 131 S. W. (2d) 1085; *Dixie Motor Coach Corp.* v. *Watson* (Civ. App.), 138 S. W. (2d) 314; *Taylor* v. *Suloch Oil Co.* (Tex. Civ. App.), 141 S. W. (2d) 657; *Johnson* v. *Commissioner, supra; McFadden* v. *Commissioner* (C. C. A. 5), 148 Fed. (2d) 570; 11 Am. Jur. 198, Sec. 38.

(d) The trial court held that the oil and gas leases which were purchased by Trapp, with Blankenship, as tenants in common, and operated in partnership, or purchased in partnership with Blankenship, although purchased and paid for with joint and community funds of the husband and wife, were Trapp's separate property, and the gain from the leases, although produced through the use of the labor, skill and supervision of Trapp, were Trapp's separate gain and not community under Texas law.

The trial court held that, since the legal title of that portion of the leases which was purchased by the Trapps was held as tenant in common, or in partnership with one Blankenship, a different rule was applied and therefore all of the ownership would be Trapp's separate ownership and likewise the income therefrom (R. 28). The trial court did not attempt to classify income under the principle of Texas community law, as stated in (a) above. The Texas Statutes on Community Law make no exceptions as to how title is held, either as to determining ownership as between husband and wife, or as to the classification of the gain as community or separate between husband and wife. Properties held by partnership of husband and third party can

and will, under like circumstances, be community property and likewise the classification of income therefrom. *Adams* v. *Blumenshine* (N. Mex.), 204 Pac. 66, 20 A. L. R. 369; *Turman* v. *Turman* (Tex. Civ. App.), 62 S. W. (2d) 615; G. C. M. Opinion 13742, Cum. Bul. XIII-44-7100.

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January, 1950.

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 560

M. E. TRAPP, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 12-31) are reported at 73 F. Supp. 385 and at 79 F. Supp. 320. The opinion of the Court of Appeals (R. 259-267) is reported at 171 F. 2d 1.

JURISDICTION

The judgment of the Court of Appeals was entered September 14, 1949. (R. 266-267.) A petition for rehearing was denied November 2, 1949.

(R. 280.) The petition for certiorari was filed January 27, 1950. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether a valid partnership for federal revenue purposes existed between taxpayer and his wife for the year 1940.

2. Whether the doctrines of *res judicata* and equitable estoppel are applicable to an agreed judgment entered pursuant to a compromise agreement and without litigation in a different taxable year and not predicated on either a stipulation of facts or on findings of fact.

3. Whether the lower courts erred in determining the allocation of income derived from oil leases in a community property state between a husband and wife residing in a non-community property state.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from in-

terest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U.S.C. 1946 ed., Sec. 182.)

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

* * *

STATEMENT

The deficiency upon which this litigation is predicated was based in part upon a determination by the Commissioner that no valid partnership existed between taxpayer and his wife for federal revenue purposes. Prior to the marriage of the taxpayer and his wife, Lou Strang Trapp, in 1907, she had a small estate. For several years after the marriage the only bank account of the Trapps was in Mrs. Trapp's name. Sometime after 1927, taxpayer became successful in the oil leasing and production business. (R. 21-22.) The businesses of the taxpayer have been conducted by the taxpayer. Mrs. Trapp has never taken an active part in any of the businesses. In 1935, for the first time, taxpayer divided his income between himself and his wife and then only for his federal income tax return. Between that year and the year in question, 1940, he continued to make equal division of his income with his wife on income tax returns. (R. 22.) The Trapps never filed a partnership information tax return. During the years of their marriage there has never been a written agreement of partnership. Purchases were all made in Trapp's name, as a general rule, and neither Trapp nor his wife held out any of Trapp's ventures as partnership transactions. On the contrary, he operated and carried on all the business ventures as his own. The withdrawals by Mrs. Trapp were only for household expenses, clothes and other "housewife" expenditures. (R. 22.)

On these facts, the trial court concluded that taxpayer had failed to prove a substantial contribution by his wife and that the long course of conduct refuted an assumption of partnership. (R. 22-23.)

A part of the deficiency tax assessed against the taxpayer was based on disallowance of the equal division between husband and wife in the 1940 income tax return of the income from Texas oil properties as community income. (R. 23.) Prior to this litigation, in 1935, the taxpayer had returned the income from the Texas oil properties as community income of himself and his wife. The division was disallowed and a deficiency assessed. Administrative proceedings for refund were had and, upon refusal, suit was filed with the Board of Tax Appeals seeking allowance of the refund. Therein the taxpayer complained of the deficiency assessment because of the failure of the Commissioner to recognize the income from the Texas oil properties as community income under the Texas law. Though the title to the property was taken by Trapp in his name, he asserted that the consideration for such property consisted of personal services rendered by him in Texas in obtaining the properties and of funds belonging to himself and his wife. (R. 23-24.)

There was never a trial of the case. A stipulation was agreed upon stating the amount of a deficiency, which deficiency excluded any tax upon the one-half of the income from the Texas properties attributed to the income of Mrs. Trapp. Upon this stipula-

tion an order was entered May 15, 1940, which recited: "Ordered and Decided: *There* there (sic) is a deficiency in federal income tax for the year 1935 in the amount of $643.52." The order was *pro forma* and not on the merits. (R. 24.)

The so-called King, Crisp and Bob White leases were purchased by taxpayer in 1932 with cash and required the rendition of some services by taxpayer in Texas in obtaining the leases. To the extent of the services the property was recognized by the lower courts to be community property. (R. 25-26, 264-265.) To the extent of the cash paid for the leases, since they were purchased with the taxpayer's separate property, the leases were themselves treated as separate property. (R. 26-28.) Following these criteria, an allocation was made by the trial court (R. 26-28) and approved by the Court of Appeals. (R. 264-265.) As for the so-called Moseley, Milas and Fenn leases, held by taxpayer in partnership with one Blankenship, the trial court found that the money borrowed by Trapp and any cash Trapp may have had on hand which went into the leases was his separate property; and since the court failed to find that taxpayer rendered any services in Texas in connection with these leases, it held that all of the income derived therefrom was taxable to him. (R. 28.) As in the case of the other determinations of the trial court, this conclusion was approved by the Court of Appeals. (R. 265-266.)

ARGUMENT

1. The Court of Appeals correctly determined that the doctrines of estoppel by judgment and *res judicata* are inapplicable in the case of an agreed judgment on a different cause of action where that judgment merely sets forth the amount of the deficiency, pursuant to a compromise agreement reached without actual litigation, and where it is predicated on neither a stipulation of facts nor on findings of fact. The lower court's conclusion in this respect is in harmony with, and was in fact required by, decisions of this Court. *Commissioner* v. *Sunnen,* 333 U. S. 591; *New Orleans* v. *Citizens' Bank,* 167 U. S. 371; *Tait* v. *Western Md. R. Co.,* 289 U. S. 620. Other courts of appeals have come to the same conclusion in like circumstances. *Gillespie* v. *Commissioner,* 151 F. 2d 903 (C. A. 10th); *Henderson* v. *United States Radiator Corp.,* 78 F. 2d 674 (C. A. 10th); *Hartford-Empire Co.* v. *Commissioner,* 137 F. 2d 540 (C. A. 2d); *Blaffer* v. *Commissioner,* 134 F. 2d 389 (C. A. 5th). This Court pointed out in *Commissioner* v. *Sunnen, supra,* p. 598, that where, as here, a different cause of action is involved, the taxable years being different—

> the judgment in the prior action operates as an estoppel, not as to matters which might have been litigated and determined, but "only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered." *Cromwell* v. *County of Sac,* [94 U. S. 351,] 353.

Moreover, as the trial court observed (R. 25), entirely apart from the nature of the earlier judgment and the circumstances of its entry, the doctrine of estoppel would have no proper application here; for that judgment, based as it was upon the allocation of family income between husband and wife for federal revenue purposes, was prior to the controlling decisions of this Court in *Helvering* v. *Clifford,* 309 U. S. 331; *Helvering* v. *Horst,* 311 U. S. 112; *Commissioner* v. *Tower,* 327 U. S. 280; *Lusthaus* v. *Commissioner,* 327 U. S. 293; *Commissioner* v. *Sunnen, supra;* and *Commissioner* v. *Culbertson,* 337 U. S. 733. In the words of this Court in the *Sunnen* case, *supra* (p. 600):

> a judicial declaration intervening between the two proceedings may so change the legal atmosphere as to render the rule of collateral estoppel inapplicable.

The cases relied upon by the taxpayer are easily distinguishable and, in view of the thorough analysis of the problem by this Court in the *Sunnen* case, *supra,* require no discussion.

2. The appellate court's approval of the trial court's determination that taxpayer had failed to establish the existence of a "genuine" partnership for federal revenue purposes conforms with the decisions of this Court in *Commissioner* v. *Tower, supra; Lusthaus* v. *Commissioner, supra;* and *Commissioner* v. *Culbertson, supra.* The reasons asserted in this connection by the taxpayer for the

granting of his petition for certiorari are in large measure the same as those proposed in *Kohl* v. *Commissioner,* 170 F. 2d 531 (C. A. 8th), certiorari denied, 337 U. S. 956, rehearing denied 338 U. S. 839; *Fainblatt* v. *Commissioner,* 172 F. 2d 389 (C. A. 2d), certiorari denied, 337 U. S. 957, rehearing denied, 338 U. S. 841; *Moore* v. *Commissioner,* 170 F. 2d 191 (C. A. 4th), certiorari denied, 337 U. S. 956, motion to file petition for rehearing denied, 338 U. S. 841; and *Eisenberg* v. *Commissioner,* 174 F. 2d 827 (C. A. 3d), certiorari denied, January 9, 1950.

The District Court did not, as suggested (Br. 23-24), rely solely upon the presumptive correctness of the Commissioner's deficiency determination but rather based its conclusion on its findings of fact made after a careful review of the evidence. The trial court's findings of fact, which were in every case supported by the evidence, were, *inter alia,* that "the businesses of the taxpayer have been conducted by Trapp"; that "Mrs. Trapp has never taken an active part in any of the businesses"; that "purchases were all made in Trapp's name, as a general rule, and neither Trapp nor his wife held out any of Trapp's ventures as partnership transactions"; that "he operated and carried on all the business ventures as his own"; that "the Trapps never filed a partnership information tax return"; that "during the years of their marriage there has never been a written agreement of partnership";

that "the withdrawals by Mrs. Trapp were only for household expenses, clothes and other housewife expenditures"; that, despite the fact that the purported contributions from which taxpayer seeks to justify the partnership occurred approximately twenty-five years earlier, "in 1935, for the first time, taxpayer divided his income between himself and his wife and then only for his federal income tax return"; that "the long course of conduct * * * strongly refutes an assumption of partnership"; and that the taxpayer "failed to establish a substantial contribution by Mrs. Trapp." (R. 22-23.)

Moreover, it is not true that the undisputed evidence indicated a substantial contribution by Mrs. Trapp. (Br. 34.) On the contrary, the fund purportedly contributed by Mrs. Trapp to the alleged partnership "was invested in municipal bonds and profits from the business remained in municipal bonds" (R. 81); and the record fails to disclose that this fund ever found its way into the purported partnership. According to the testimony of the Government's agents, the taxpayer had himself indicated that any contribution by his wife to a common fund was negligible. (R. 185, 187, 189-190.) Most important is the fact that, although the purported contribution occurred in 1907, there was absolutely nothing in the taxpayer's records or in the conduct of Mr. and Mrs. Trapp to indicate the existence of a partnership until 1935 when they first divided their income and then only for income

tax return purposes. (R. 14-15, 106-117.) In short, there is nothing in this record to indicate that "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner* v. *Culbertson, supra,* p. 742.

3. The principles of law enunciated by the lower courts in connection with the allocation of income derived from the operation of oil and gas leases in Texas conformed to the applicable state law. The general rule is that marital rights in real property located in Texas are governed by the law of Texas regardless of the residence of the spouses. The Texas law is, however, that property purchased with the separate property of one spouse is itself separate property. *Hammonds* v. *Commissioner,* 106 F. 2d 420 (C. A. 10th); *Noble* v. *Commissioner,* 138 F. 2d 444 (C. A. 10th). Since the lower courts found that the so-called King, Crisp and Bob White leases were purchased with the taxpayer's separate property, the leases were themselves to be treated as his separate property to the extent of their cost.[1] To the extent of the value of the taxpayer's services rendered in connection with the acquisition and development of the property, the courts recognized the taxpayer's privilege of treating the income as

[1] Since both lower courts concluded that there was no such confusion and commingling of separate and community funds as to render the funds unidentifiable, it is unnecessary to consider what the consequences would be if the funds had been so commingled as to render it impossible to identify them with reasonable certainty. (R. 265.)

community income under Texas law. (R. 265.) *Hammonds* v. *Commissioner, supra.* *Noble* v. *Commissioner, supra.* Moreover, taxpayer has little cause for complaint in view of the fact that the services which served as the basis for a community income allocation were described by him in the most vague and uncertain terms (R. 123-140), and were purportedly rendered during a period when he was fully employed as a corporation executive (R. 164). As for the Moseley, Milas and Fenn leases, which were held in partnership by taxpayer and one Blankenship, since the District Court found that taxpayer and Blankenship "each contributed one-half of the purchase price" (R. 28) and since there was no finding that the taxpayer had rendered any services in connection with the acquisition of the leases, the lower courts properly concluded that none of the income derived therefrom was community income.

CONCLUSION

The determination of the lower court is correct and involves no conflict with any other decision. The case involves only the application of settled principles to its particular facts, and there is no occasion for further review. The petition for a writ of certiorari should be denied.

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FEBRUARY, 1950.

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